No. 8425

In the United States Circuit Court of Appeals

For the Ninth Circuit

In the Matter of
JAMES MARTIN KIRKPATRICK,
Debtor.

E. H. HARDT,
Appellant,

vs.

JAMES MARTIN KIRKPATRICK,
Appellee.

Appellee's Brief

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STATEMENT OF THE CASE

Appellant under statement of the case on page 6 of brief says that the foreclosure proceedings under Deed of Trust must be assumed to be prior to initiation of bankruptcy proceedings; but there is not a word in the record to warrant such assumption. However, on page 11 of brief he admits that it would make no difference if the bankruptcy proceeding was first instituted as

found by the Judge (Tr., page 30) with which admission we agree.

Over six months after commencement of proceedings under Section 75, appellant asked the court's permission to foreclose his Deed of Trust and sell the property which petition was denied September 26, 1936. (Tr., page 18.) The property during all of the time mentioned was in possession of the debtor under the court and after debtor had been adjudged a bankrupt under subsection (s) appellant again recognized the necessity of getting the court's consent to sell by filing a Petition for Review of the Order denying his Petition to sell, which Review is still pending. Thereafter, on October 13, 1936, he disregarded the order and jurisdiction of the court and had the property sold under his Deed of Trust. (Tr., page 18.)

Appellee's contention is that a sale of encumbered property in the exclusive possession of the bankruptcy court and in possession of the bankrupt at the time of adjudication cannot be made without the court's consent after adjudication. In ordinary bankruptcy the exception to the rule is where property has become subject to the jurisdiction of some other court in foreclosing valid lien thereon prior to filing the petition in bankruptcy, the bankruptcy court under the rule of comity will not ordinarily interfere, but Section 75 even prohibits the maintenance of such suits in other courts. Section 75 (a to r) and (s). Subsection (n) of Section 75 expressly gives the bankruptcy court exclusive jurisdiction of debtor's property, including property

"Where a Deed of trust has been given as security or where the sale has or had not been confirmed or where the deed had not been delivered at the time of filing petition. In all cases where at the time of filing the petition the period of redemption has not or had not expired *or where the right under a deed of trust has not or had not become absolute,* or where the sale has not or had not been confirmed or where deed had not been delivered, the period of redemption shall be extended or the confirmation of sale withheld for the period necessary for the purpose of carrying out the provisions of this section."

Subsection (o) provides if foreclosure proceedings have been instituted prior to the filing of the petition it

"Shall not be maintained"

except by order of the Judge.

Subsection (p) as amended extends prohibition of subsection (o) to all creditors and official proceedings as well as judicial proceedings. Therefore no sale could have been had nor a proceeding to sell have been maintained while proceedings were pending under Section 75 without the court's consent.

In re: O'Brien, 9 Fed. Supp. 892 (N. Y. D. C.)

After the adjudication the property still remained under the exclusive jurisdiction of the court, but appellant contends that after adjudication and prior to the court making the order for debtor to retain possession for three years and staying proceedings the secured creditors could ignore the court and help them-

selves to the security, which of course would destroy the very purpose of the act. Appellant asserts three years' stay is not automatic. As sub-section (s) provides for the court to stay all judicial and official proceedings only after and not before debtor's property has been appraised, exemptions set aside and possession ordered to remain in the debtor and the conditions of Section 75 have been complied with therefore prior to such stay order staying proceedings for three years the secured creditors could help themselves to their security. This would amount to a nullification of the essential purpose of the act and amount to closing the barn door after the horse was stolen. The bankruptcy law already by effect of adjudication stops secured creditors from coming in and robbing estates before the court has a chance to act. We use the word robbing because that actually would be the effect if the law was as contended for by appellant.

In an involuntary bankruptcy proceeding as a rule the petitioning creditors have such interest in the assets as to watch the disposal of them before adjudication and to see that an attempted disposal was enjoined and the alleged bankrupt resisting the proceedings also would consider himself as having an interest in the property worth protecting, but in voluntary bankruptcy invariably adjudication is made upon the same day the petition is filed and general creditors have no notice of it until a month later. The Bankrupt himself has abandoned his interest so that the vigilant secured trust deed holders would have ample time before credi-

tors elect a trustee to hold a sale after adjudication, buy the property in for a small percent of its value and as there is no redemption from such sale the allowing of such proceeding would actually amount to the allowance of legal robbery as against the interest of General Creditors.

The fact that in this case the market value was paid for the property will not validate sale for the law does not allow anyone to take property illegally merely by paying market value. The principal purpose of the act is to prevent property from being taken at the market value during the time of depression values and to enable debtors to save their farm homes from such sales by equitable protection to creditors until values in some measure could be restored. Paying a reasonable price cannot validate illegal taking of property from the jurisdiction of the court.

SALE OF PROPERTY IN POSSESSION OF THE BANKRUPT AFTER ADJUDICATION IS INVALID WITHOUT CONSENT OF THE COURT.

There is no case decided by our Supreme Court nor by our Circuit Court of Appeals which has upheld such sales after adjudication.

The case of Hefron vs. Western Loan & Building Company, 84 Fed. (2d) 310, relied upon by appellant is not in point, as sale there was prior to adjudication. Likewise in Robinson vs. Kay, 7 Fed. (2d) 576 (9 C. C. A.), hence sales were held valid. The court stated

that the facts in that case were similar to the facts in Hiscock vs. Varick, 51 L. Ed. 945 (U. S. Supreme Court) in that sale was after the filing of petition and before adjudication.

Likewise a statement in the Hefron vs. Western Building & Loan Company, supra, about sale being valid unless enjoined has no application nor reference to a sale after adjudication of property in the actual possession of the bankruptcy court as is specifically stated by our Supreme Court in the case of Isaac vs. Hobbs T. & T. Co., 75 L. Ed., page 645, where the Supreme Court said:

> "Injunctions are granted solely for the reason the court in which foreclosure proceedings are instituted is without jurisdiction after adjudication."
>
> "Upon adjudication title to the bankrupt's property vests in the Trustee with actual or constructive possession and is placed in the custody of bankruptcy court."
>
> "It follows that bankruptcy court has exclusive jurisdiction to *deal* with the property of the bankruptcy estate."
>
> "Thus while valid liens existing at the time of commencement of a bankruptcy proceeding are preserved, it is *solely* within the power of a court of bankruptcy to ascertain their validity and amount and to decree the *method of their liquidation.*"
>
> "Indeed a court of bankruptcy itself is powerless to surrender its control of the administration of the estate."

"The jurisdiction in bankruptcy is made exclusive in interest of due administration of estate."

Re: Taubal, Scott, Kitzmiller Co. vs. Fox, 68 L. Ed., page 170, the U. S. Supreme Court lays down the rule with reference to possession as follows:

"The possession which was thus essential to jurisdiction need not be actual. Constructive possession is sufficient. It exists where the property was in the physical possession of the debtor at the time of filing the petition in bankruptcy but was not delivered to him by the trustee. Where the property was delivered to the trustee but was thereafter wrongfully withdrawn from his custody.

"Where the property is in the hands of the bankrupt's agent or bailee. Where the property is held by some other person who makes no claim to it."

In Dayton vs. Stannard, 60 L. Ed., page 1191, the United States Supreme Court held invalid a sale for taxes and special assessments of real property belonging to a bankrupt where made without leave of the bankruptcy court citing and approving in re Epstein, 156 Fed., page 42 (C. C. A. 8th C.). In this case it was contended that the sale was valid as it did not interfere with the possession of the bankruptcy court, but our Supreme Court held otherwise.

The case that comes the nearest to supporting appellant's contention is in re Smith, 3 Fed. (2d), page 40, but the principal cases cited therein are squarely

against the decision made. Furthermore, that case is inconsistent with itself as it admitted the following:

> "That property which is actually *in custodia legis* cannot be put up at forced sale without the consent of the bankruptcy court."

In that case the sale was upheld where notice of foreclosure had been posted before filing of petition in bankruptcy upon the absurd theory that constructive possession was thereby given before adjudication. Under the California Statutes the beneficiary under a Deed of Trust is not entitled to possession prior to becoming a purchaser under the foreclosure sale. (Cal. C. C. P., 1161-a.)

In the case at bar, there is no question about possession actual and constructive being in the bankruptcy court.

The case of Cohen vs. Nixon & Wright, (Dist. Ct., Ga.) 236 Fed., page 406, contains a most lucid review of authorities, citing decisions from the United States Supreme Court and this 9th Circuit Court of Appeals, showing the rule laid down by our Supreme Court as follows:

> "Trust deed holder has no right to exercise power of sale contained in security deed after debtor has gone into bankruptcy without permission of the bankruptcy court."

DISTINCTION BETWEEN SALES BEFORE ADJUDICATION AND SALES THEREAFTER

Appellant on page 10 of brief asserts there is no such distinction. This conclusion is based upon a gross

misinterpretation of the case of Hefron vs. Western Loan & Building Company, Supra, and failure to comprehend the real meaning of the language used by this Honorable Court with reference to the effect of title passing upon adjudication by relation back to date of filing petition and the actual passing of title as of date of adjudication under Section 70-a of the Bankruptcy Act.

Prior to adjudication unless enjoined or a receiver is appointed, the legal title is in the bankrupt and he may continue his business and make sales which will be valid as against innocent purchasers under fair sales, but upon adjudication title vests in the bankruptcy court absolutely. Debtor no longer can make sales nor can anyone else sell his interest without the court's consent. The only exceptions are as to property not in the possession of the bankrupt at the time of bankruptcy or in cases of necessity sales of perishable which is excepted out of the law. Jones vs. Springer, 57 L. Ed., page 61 (U. S. Supreme Court).

The distinction is specifically brought out by said Hefron vs. Western Loan & Building Company case itself where it quotes from the United States Supreme Court case of Hiscock vs. Varick Bank as follows:

> "According to the terms of the Bankrupt act, the title of the bankrupt is vested in the trustee by operation of law as of the date of adjudication. Act of 1898, paragraph 70a e. . . . By the Act of 1867 (14 Stat. at L. 522, Chap. 176) it was provided that as soon as an assignee was appointed

and qualified the judge or register should, by instrument, assign or convey to him all of the property of the bankrupt, and such assignment shall relate back to the commencement of the proceedings in bankruptcy, and, by operation of law, shall vest the title to such estate, both real and personal, in the assignee. But paragraph 70a of the Act of 1898 omits the provision that the Trustee's title 'shall relate back to the commencement of the proceedings in bankruptcy' and explicitly states that it shall vest 'as of the date he was adjudged a bankrupt'."

The 7th Syllable of said United States Supreme Court case stated:

"The power of sale may be exercised by a pledge conformably to the contract of pledge during the time between the filing of the petition in bankruptcy against his pledgor and the adjudication in bankruptcy."

Collier on Bankruptcy, 13th volume, explains this distinction under Section 70 of the Bankruptcy Act, page 1635, as follows:

"Time of Vesting.—(1) In General.—Under the previous law the trustee's title vested by relation as of the date of the commencement of the proceeding. This cast doubt on the validity even of *bona fide* transactions between petition filed and adjudication; in short, made business by an alleged, but not yet adjudicated, bankrupt practically impossible. Under the act of 1841, there seems to have been a similar doubt. The words

'as of the date he was adjudicated a bankrupt' seems to have been inserted to meet these difficulties. They are not antagonistic to the words found later in subdivision (5). The former refer to the time of vesting; the latter to what vests.

(2) Title Vests at Adjudication but relates back to filing of petition. While it is true that by subsection (a) the trustee, upon his appointment and qualification, becomes vested by operation of law with the title of the bankrupt as of the date he was adjudged a bankrupt, there are other provisions of the statute which evidence the intention to vest in the trustee the title to such property as it was at the time of the filing of the petition, the estate being considered as *in Custodia Legis* from that time."

Section 70 (e) of the Bankruptcy Act provides:

"The Trustee may avoid any transfer by the bankrupt of his property, which any creditor of such bankrupt might have avoided, and may recover the property so transferred or its value from the person to whom it was transferred *unless he was a bona fide holder for value prior to the date of adjudication.* Such property may be recovered or its value collected from whoever may have received it, excepting a *bona fide* holder for value."

Collier on Bankruptcy under the above Section 70 in Volume 2 on page 1784, states:

"The saving clause as to *bona fide* holders for value in this subsection is similar to those found in Section 67e and 67f, and is for the same purpose.

> What has already been said of them will not be repeated here. This saving of the rights of the *bona fide* holders for value is also merely expressive of the law, but *after adjudication the filing of the petition amounting to constructive notice, there can be no bona fide holder.*"

Some sentences of said 9th Circuit Court of Appeals in the Hefron case have been misinterpreted as for instance the following:

> "Manifestly the mere fact that the bankrupt's property comes into *custodia legis* or that title passes to the trustee, does not *ipso facto* void a subsequent foreclosure of a lien against the property."

That statement is absolutely true in harmony with the decision on the issues in the case and is equally applicable to several other instances that can be mentioned as for instance where an execution has been levied upon property prior to the filing of petition in bankruptcy and the lien under said levy is not a preference and that state court has possession of the property levied upon. A sale under such valid lien by the state court may be had subsequent to adjudication as by the rule of comity where the court has possession of the rem prior to the bankruptcy proceedings the bankruptcy court will not interfere with such sale unless some equitable grounds for injunction should be shown. This has been decided by the United States Supreme Court in 71 U. S. L. Ed., page 1339, in the case

of Wilkinson vs. Goree, et al., approving decision of the 5th Circuit Court of Appeals. Likewise where a pledgor has possession of a pledge under a valid lien prior to bankruptcy proceedings, his sale of the pledge under his contract subsequent to adjudication is valid, but may be enjoined under decision of the United States Supreme Court in the case of Continental vs. Chicago, Rock Island, etc., 79 L. Ed. 1110, under Section 77 which is similar to Section 75 giving the court exclusive jurisdiction over debtor's property wherever located even against an adverse claimant in possession.

Appellant having submitted himself to the court's jurisdiction asking permission to sell and asked review of order denying him that right after adjudication, but thereafter selling the property in defiance of the court's denial clearly appears to be a contempt of court and should not be permitted.

There are a number of District Court cases supporting appellee's contention but as they do not control this court we will only quote from one:

In Re Cope; In re Chelton; U. S. D. C., Colo., Jan. 2, 1935, 8 Fed. Supp. 777, held as follows:

> "We think it is clear that Congress intended the filing of such petition by the farmer was a caveat to all the world that all legal proceedings against the farmer either divesting him of the title to the property or of the possession of the property should cease upon the filing of such petition, and that thereafter the farmer's rights with respect to the title or possession of the prop-

erty, as well as the rights of all his creditors should be submitted to and passed upon by the bankruptcy court to the exclusion of all other courts. Section 75 (n) and (o) support this view."

Respectfully submitted,

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